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Speeding up the Bankruptcy Process
Lessons from Romania

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Executive Summary:

Romania capitalized on widespread support for EU accession to overhaul its bankruptcy law. The reform included creating a Best Practices Manual, an online insolvency notification bulletin, and a fund to compensate insolvency practitioners when clients have insufficient funds for payment.

Introduction

Bankruptcy reform takes longer, is more complex, and is less glamorous than most other aspects of business environment reform. An efficient system for business exit, however, is vital for a well-functioning economy. It facilitates more productive uses of people and capital, and when creditors believe they have a better chance to recover their funds, they are more likely to lend with less collateral.

Romania passed a new bankruptcy law as part of its reforms to join the European Union (EU). The reforms successfully incorporated benefits from technology, and the new law was written with an eye toward further improving the law.

Context

In 2002, the World Bank's Action Plan for Romania's Private Sector Adjustment Loan II recommended an assessment of bankruptcy and collateral legislation, which World Bank consultants performed from February 2002 to May 2002.

Based on the World Bank's recommendations, the Ministry of Justice requested EU assistance through the PHARE program (Programme of Community aid to the countries of Central and Eastern Europe), which assists applicant countries in their preparations to meet the requirements of EU accession. The program was approved in 2002, but delays due to administrative issues, presidential elections, and illnesses of key project team personnel caused the project not to begin in earnest until 2005.

Concerns over EU accession galvanized support. In the meantime, the European Commission issued its 2004 Regular Report on Romania's Progress toward Accession, which emphasized bankruptcy as an area requiring major reform. According to the report, "the judicial system has so far been unable to provide an effective exit mechanism from the market, in particular due to the legislation's weak creditor protection. Furthermore, complex procedures, insufficient administrative capacity and uneven application of the law remain impediments to effective competition."

At the time of the 2004 report, Romania's planned 2007 accession remained uncertain. It was still potentially subject to the "safeguard clause," which could have delayed entry to the EU by one year. Romania's political establishment was nearly unanimous in its support for timely EU integration and, therefore, also strongly supportive of bankruptcy reform. Following the issuance of the report, the prime minister declared that the substance and degree of the necessary reforms and amendments demanded a new insolvency law.

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Support for the Reform was Widespread
The Ministry of Justice acknowledged that the process of closing a business was not at European standards. In 2004, it undertook its own assessment of the effectiveness of the legal and institutional framework as applied in specific courts, such as the Bucharest Tribunal. Based on what it learned through this evaluation, the Ministry of Justice helped initiate the reform process.

The Ministry of Finance also threw its support behind bankruptcy reform. As the lead ministry on the governmentwide Convergence Program for a Modern European Society, the Ministry of Finance was charged with guiding the implementation of business environment reforms including the legal framework regarding bankruptcy, "with a view to enforcing fiscal discipline and promoting competitiveness."

Finally, the Union of Insolvency Practitioners (UNPRL), created in 1999, advocated strongly for reform. The practitioners were frustrated by the length of bankruptcy proceedings and difficulties in receiving payment.

Approach

The EU provided not only the political motivation for reform action, but also the capacity through its PHARE program. A representative of the EU delegation reflected that there was a sense of "lethargy because of the work involved." However, once the PHARE program was established and funding was in place for a contractor to do the detail work, the stakeholders readily came aboard the project.

The approved project had four parts: to improve the legal and institutional framework on bankruptcy in order to render the procedure more efficient; to create a Best Practices Manual; to develop a software application; and to deliver specialized training for judges, lawyers, liquidators, accountants, and clerks.

In 2005, a team was assembled that included consultants, syndic judges, insolvency practitioners, representatives from the Superior Court of Magistrates, and law professors who developed draft legislation based on EU norms and the U.S. bankruptcy code. In order to keep support strong and limit potential opposition to the reforms, the Ministry of Justice organized a number of debates on the draft law, with all interested parties being invited.

Further support was given to the new bankruptcy law by including it in the Ministry of Justice's anticorruption and business environment improvement strategy, which the government prioritized in its discussions with Parliament.

Although an amendment to the existing law could have been approved by a simple government decision, the reform team determined that a new law was needed. The existing bankruptcy law had been subject to 2 republishings and 10 separate amendment procedures with some of these amendments affecting nearly 100 articles. Therefore, there was a need for a new, coherent law that would not conflict with other laws. The legal scholars involved in the process believed that it could be a building block for an eventual bankruptcy code similar to the U.S. model.

Key aspects of the new law include the following:
Reduction of the syndic judge's role
One of the most important elements of the insolvency law is the reduction of the syndic judge's responsibilities. The judge's role is to settle disputes and ensure the legality of the proceedings, while an insolvency practitioner serves as the administrator of the company.

Increased role of the insolvency practitioner
Under the new law, an insolvency practitioner serves as the bankruptcy administrator. The administrator evaluates the company's situation, decides the appropriate resolution under the supervision of the creditors' committee, and makes decisions on issues such as payments.

Increased creditor authority
The creditor committee is empowered to supervise the insolvency practitioner and initiate a hostile takeover if the shareholders do not wish to participate in the proposed reorganization plan. The creditors may contest the decisions of the insolvency practitioner and negotiate his or her fees.

Simplified bankruptcy procedure
Individuals, small trading companies, companies with no activity, and companies with unanimity among the shareholders and creditors may elect a simplified bankruptcy procedure that excludes the possibility of reorganization and enables the company to begin a bankruptcy proceeding as soon as 60 days from the opening of the insolvency procedure.

"[M]ore active use of bankruptcy or other forms of liquidation remains a prerequisite for effectively reallocating resources to more productive uses."

–2004 Regular Report on Romania's Progress Toward Accession

Priority of payment
The priority order for payment by the debtors is creditors, employees, financial institutions, and state.

Best Practice Manual
The reform included the development of a Best Practices Manual for the field of insolvency, which was made available on the Ministry of Justice website. The manual comprises best practice regulations, relevant jurisprudence in the field, standard forms, and practical recommendations.

Software application

A new document filing and management system, or an "electronic dossier," was created to implement standard forms based on the provisions of the new insolvency law. This software application integrates the electronic standardized forms within the existing case management document system used by the Romanian judiciary, ECRIS.
Funding for the reforms was provided by the PHARE program at a total cost of €1.5 million for the drafting of the law, training, and development of a software application.

The draft law was passed by Parliament in April 2006 and went into force in July 2006. Since adoption of the new law, an Insolvency Bulletin was created to provide online procedural notifications, and key personnel have been trained. The software application that will provide the courts with an "electronic dossier" was scheduled to go online in September 2006.

Results

The Ministry of Justice planned to conduct a new assessment to begin in the second half of 2007 to assess the performance of the reforms. They sought to measure:

- Progress regarding the length of the procedures;
- Performance of the electronic dossier; and
- Performance of the interaction between the Insolvency Proceedings Bulletin and the electronic dossier.

As of September 2006, it was too early to gauge the extent of the new law's impact; however, there are promising signs that large benefits will be realized from the reform.

Online Insolvency Bulletin
The migration to an online insolvency bulletin in place of written notices of insolvency proceedings by registered mail is seen as making an immediate impact by reducing the time of bankruptcy proceedings. It began operating in August 2006 and has reduced the time from notification to the start of proceedings to one to three months. This reform is expected to be the most effective in reducing the overall time to close an insolvency proceeding.

According to Gheorghe Piperea, vice-president of the Insolvency Practitioners Union, prior to the reform, there were frequently cases where a shareholder would live overseas and it would take six months to complete the process of notifying the shareholder by registered mail and opening the proceeding.

Practitioners Fund
The other reform that made an immediate impact was the transfer of 20 percent of the insolvency practitioner's fee to a Union of Insolvency Practitioners Fund. Mr. Piperea of the union explained this fund was developed for cases in which there are insufficient assets or funds to pay the insolvency practitioner. Previously, insolvency practitioners were hesitant to accept difficult cases that could last several years when there was a high risk of not receiving remuneration. The fund has greatly reduced that concern.

Training
The PHARE project resulted in the training of 580 judges, insolvency practitioners, and clerks. Generally, the training was well received, but more specialized training is needed.

Conclusions

Best Practices Manual
The Best Practice Manual for insolvency practitioners is based on the tenets of the new law, jurisprudence in other countries, and other best practices. It was published several months before the adoption of the law, however, and therefore does not completely correspond to the final version of the law. Contrary to what was planned, a revised version of the manual was not produced in the six months following implementation of the law. Participants in the process recommend ensuring that the publication of accompanying documents coincides with the adoption of the final version of the law.

"[The new law] is part of a wider process of the reform of the legal and institutional framework in Romania which takes place in the run-up to the country's expected admission to the EU."

–Speranta Munteanu, project manager for the PHARE program

Outside Assistance

Legislative projects frequently conclude when the law is delivered to Parliament, and then the law languishes without the support of its creators. In this case, the EU delegation in Romania was able to secure an extension for the PHARE project to work through the passage of the final version of the insolvency law. The reform team believes Brussels's flexibility in granting the extension and the contractor's capability and willingness to support the project to final passage were keys to success.

Modularity

Because of the need to complete this law and others on time for EU accession, there was not time or energy to address every aspect of insolvency that was required. As a result, there were still conflicts with existing laws and areas where other laws supersede the bankruptcy law. For example, individual laws applying to state-owned entities, banks, and insurance companies could still override the new law. A recommendation is to develop a long-term strategy for ensuring that future changes and additions to the law can be completed in a straight-forward and modular fashion.

About BizCLIR:

BizCLIR, or the Business Climate Legal & Institutional Reform Project, is a multi-year initiative of the United States Agency for International Development with the goal of improving the efficiency and impact of assistance programs intended to help developing countries improve their business enabling environments. This series, Best Practices for the Business Environment, represents one of many knowledge management components of the BizCLIR project. The goal of the series is to highlight the known best practices, case studies, lessons learned, and in some cases worst practices, so that the lessons can benefit other practitioners in the field. All issues are available at www.bizclir.com.